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In the Supreme Court of the United States

OCTOBER TERM, 1996

UNITED STATES OF AMERICA,
Petitioner,

v.

JAMES HERMAN O'HAGAN,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF NATIONAL ASSOCIATION OF CRIMINAL DEFENSE LAWYERS AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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BRIEF OF NATIONAL ASSOCIATION
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AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

This *amicus curiae* brief is submitted in support of the Respondent, James O'Hagan. By letters filed with the Clerk of the Court, Petitioner and Respondent have consented to the filing of this brief.

INTEREST OF *AMICUS CURIAE*

The National Association of Criminal Defense Lawyers ("NACDL") is a nonprofit corporation with membership of more than 9,000 attorneys and 28,000 affiliate members in all fifty states. The American Bar Association recognizes the NACDL as an affiliate organization and awards it full representation in its House of Delegates.

The NACDL was founded in 1958 to promote study and research in the field of criminal law; to disseminate and advance knowledge of the law in the area of criminal practice; and to encourage the integrity, independence, and expertise of defense lawyers in criminal cases. Among the NACDL's objectives is to ensure the proper administration of justice and to ensure that criminal statutes are construed and applied in accordance with due process.

The NACDL files this *amicus curiae* brief to urge the Court to reject the so-called "misappropriation theory" of insider trading pursuant to the federal securities laws.[1/] One of the fundamental tenets of our Constitution is that the federal government may not impose criminal punishment unless Congress has acted clearly and decisively to declare the conduct to be illegal. Congress has not taken any such action with respect to the misappropriation theory. That theory is entirely a creation of the Securities and Exchange Commission and the Judiciary, and as such cannot constitutionally serve as a basis for a criminal conviction.

1/ Mr. Mathews and Wilmer, Cutler & Pickering formerly represented Mr. O'Hagan in connection with the Securities & Exchange Commission's investigation of the events at issue in this case. They have not represented Mr. O'Hagan in any state or federal administrative, civil, or criminal litigation since that time, and do not represent him in this proceeding.

SUMMARY OF ARGUMENT

Respondent James O'Hagan, formerly an attorney in Minnesota, stole client funds and attempted to cover up that theft using the proceeds of securities trading based on information misappropriated from his law firm and its client. For these actions, Mr. O'Hagan was convicted on eight counts of theft by the State of Minnesota. He served thirty months in prison and was disbarred by the Minnesota State Supreme Court. Clearly, Mr. O'Hagan has been punished for his misbehavior, and this case does not call upon the Court to exonerate him.

The question raised by the Government's appeal is whether, in addition to that punishment, Respondent can be sent to prison for violating a judicially-constructed "theory" that has never been enacted by Congress. A fundamental tenet of the Constitution is that only Congress may legislate federal crimes. It has not done so with respect to the misappropriation of material nonpublic information by outsiders. Because Congress did not and has not acted, the Securities and Exchange Commission ("S.E.C.") and the courts have crafted a variety of standards of liability, justified by clearly important policy considerations. Regardless of the merits of these justifications, creating criminal liability is an activity solely within the province of the Congress.

Congress has been aware of the problem of trading on misappropriated information since 1934. Despite this, the legislature clearly intended only to prohibit some forms of that conduct. This was inspired, at least in part, on the understandable unwillingness of the Government to support a precise statute that would undoubtedly fail to hold all perceived wrongdoers criminally liable. As a result, the Government for the past sixty years has been able to bring cases against anyone it feels has committed a "wrong," despite the fact that Congress has never, as it must, specifically defined the offense.

ARGUMENT

I. THIS COURT SHOULD REJECT THE GOVERNMENT'S INTERPRETATION OF SECTION 10(b) BECAUSE CONGRESS NEVER ENACTED THE MISAPPROPRIATION THEORY AS A CRIME.

The Government's effort to persuade this Court to interpret Section 10(b)[2/] to encompass the misappropriation theory[3/] is a continuation of a long-standing tendency to press upon the courts expansive "interpretations" of Section 10(b) that reach far beyond any boundaries ever contemplated by Congress. Over the past 20 years, the Government has attempted to persuade this Court to interpret Section 10(b) to prohibit mere negligence (*Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976)),[4/] any trading while in

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2/ Both Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, define unlawful conduct: "It shall be unlawful. . . ." A willful violation of Section 10(b) and Rule 10b-5 is a crime by virtue of Section 32(a) of the 1934 Act. 15 U.S.C. § 78ff(a).

3/ The misappropriation theory of liability extends the classical theory of insider trading to outsiders who trade on the basis of material nonpublic information. The theory provides, according to the Ninth and Second Circuits, that Rule 10b-5 is violated when a person:

> (1) misappropriates material nonpublic information (2) by breaching a duty arising out of a relationship of trust and confidence and (3) uses that information in a securities transaction, (4) regardless of whether he owed any duties to the shareholders of the traded stock.

Securities and Exchange Comm'n v. Clark, 915 F.2d 439, 443-44 (9th Cir. 1990) (citing *Securities and Exchange Comm'n v. Materia*, 745 F.2d 197, 201-02 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985)). *Cf. Securities and Exchange Comm'n v. Cherif*, 933 F.2d 403, 410 (7th Cir. 1991) (applying the theory only to breaches of "a fiduciary relationship such as employment").

4/ While the Government was not a party in *Hochfelder*, it submitted an *amicus curiae* brief urging the Court to expand Section 10(b) to cover negligence. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197-99 (1976). Expansions of this type were also rejected in *Aaron v. Securities and Exchange Comm'n*, 446 U.S. 680, 684-86, 691 (1980) (where plaintiffs urged that "fraud" under Section 10(b) meant "negligence"); *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 441, 463 (1976) (where plaintiff asserted that "immaterial" meant "material"); and *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975) (where plaintiffs, supported by the S.E.C. as *amicus curiae*,

possession of material nonpublic information, even where there is no duty to disclose (*Dirks v. Securities and Exchange Comm'n*, 463 U.S. 646 (1983); *Chiarella v. United States*, 445 U.S. 222 (1980)), and "aiding and abetting" violations of Section 10(b) by others (*Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994)). These attempted expansions of Section 10(b) all failed, not because the Court disagreed with the policies the Government sought to advance, but because the Court adhered to the constitutional principle that Congress must make those policy judgments in legislation it enacts.[5/] Any contrary result would have, among other things, violated the long-standing principle that "[i]t is the legislature, not the Court, which is to define a crime, and ordain its punishment." *United States v. Wiltberger*, 18 U.S. (5 Wheat.) 76, 95 (1820) (Marshall, C.J.).

Under our system of government, Congress enacts statutes to define criminal conduct; there are no common law crimes.[6/] Our Constitution not only entrusts Congress with the power to describe

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suggested that "in connection with the purchase or sale of a security" meant "not in connection with the purchase or sale of a security"). *See also* Milton V. Freeman, *Foreword* to *Happy Birthday Rule 10b-5: 50 Years of Antifraud Regulation Colloquium*, 61 FORDHAM L. REV. S3 (1993) ("I was afraid that [Rule 10b-5] was being subject by plaintiffs, governmental and private, to arguments for expansion to an extent that I believed it was in danger of becoming a loose cannon.").

5/ *See, e.g., Central Bank of Denver*, 511 U.S. at 177-78 ("We cannot amend the statute to create liability."); *Chiarella*, 445 U.S. at 234 ("As we have emphasized before, the 1934 Act cannot be read 'more broadly than its language and the statutory scheme reasonably permit.'") (citation omitted); *United States v. Bryan*, 58 F.3d 933, 945 (4th Cir. 1995) ("For at least two decades, . . . the Supreme Court has repeatedly warned against expanding the concept of fraud in the securities context beyond what the words of the Act reasonably will bear.").

6/ On the contrary, "criminal conduct does not offend against the federal government unless it violates an Act of Congress." *United States v. Mandel*, 672 F. Supp. 864, 873 (D. Md. 1987), *aff'd*, 862 F.2d 1067 (4th Cir. 1988). "[H]owever deserving of punishment his conduct may seem," the federal courts may punish a defendant only if Congress has specifically defined the criminal conduct and authorized the penalty. *Viereck v. United States*, 318 U.S. 236, 243 (1943); *see Jerome v. United States*, 318 U.S. 101, 104 (1943); *United States v. Pardee*, 368 F.2d 368, 374 (4th Cir. 1966). "Federal crimes, of course, 'are solely creatures of statute.'" *Dowling v. United States*, 473 U.S. 207, 213 (1985) (*quoting Liparota v. United States*, 471 U.S. 419, 424 (1985)).

and define what conduct is to be criminal, it entrusts it with the sole responsibility to do so. Where the words of the statute enacted by Congress do not unambiguously delineate the boundary between the acceptable and the criminal, the courts may not step into the breach with a theoretical exegesis of what Congress might have done had it considered the matter.

It is this principle that animates the rule of lenity. As this Court has held, "before one can be punished, it must be shown that his case is plainly within the statute." *Fasulo v. United States*, 272 U.S. 620, 629 (1926) (citation omitted). Where the "text, structure, and history fail to establish that the Government's position is unambiguously correct — we apply the rule of lenity and resolve the ambiguity in [the Respondent's] favor." *United States v. Granderson*, 511 U.S. 39, 54 (1994) (citation omitted). The rule both ensures fair warning of the boundaries of criminal conduct and ensures that it is the legislature that defines criminal liability. *Crandon v. United States*, 494 U.S. 152, 158 (1990); *see also Rewis v. United States*, 401 U.S. 808, 812-13 (1971).

The misappropriation theory bears all the hallmarks of a common law crime. Its grounding in the statutory language is, at best, tenuous. After more than fifteen years of development in the courts, it remains an imprecise theory that prohibits any persons from trading on the basis of material nonpublic information obtained through the breach of some state or common law duty. Even the *amici* supporting the Government acknowledge that the theory is vague, has been developed through case-by-case application in the federal courts, and fails to define with precision the conduct it prohibits.[7/]

The Government and the lower federal courts that have decided to "adopt" the misappropriation theory do not agree among themselves as to what it prohibits. The Government believes the theory applies whenever a person breaches "a fiduciary or similar duty of trust and confidence." *See* Gov't Br.

7/ *See* Brief for Ass'n for Investment Management and Research as *Amicus Curiae* at 3- 6, 11-17; Brief for North Am. Sec. Adm'rs Ass'n and Law Professors as *Amici Curiae* at 2-3, 12-13.

at 12. The Seventh Circuit applies the theory only to breaches of "a fiduciary relationship such as employment." *Securities and Exchange Comm'n v. Cherif*, 933 F.2d 403, 410 (7th Cir. 1991); *see also Securities and Exchange Comm'n v. Maio*, 51 F.3d 623, 631 (7th Cir. 1995). By contrast, the Second and Ninth Circuits prohibit any breach of "a relationship of trust and confidence." *Securities and Exchange Comm'n v. Clark*, 915 F.2d 439, 443-44 (9th Cir. 1990) (citing *Securities and Exchange Comm'n v. Materia*, 745 F.2d 197, 201-02 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985)).

The *amici* supporting the adoption of the misappropriation theory are not unified in their approaches either. One group would impose Section 10(b) liability on any person who "has been entrusted with material nonpublic information and assumed a duty not to use it for personal profit." Brief for North Am. Sec. Adm'rs Ass'n and Law Professors as *Amici Curiae* at 3. Another, conceding the significant uncertainty as to the breadth of the misappropriation theory, would criminalize any disclosure of material nonpublic information "if the disclosure is for personal gain." Brief for Ass'n for Investment Management and Research as *Amicus Curiae* at 3 (emphasis omitted).

Application of these uncertain standards has resulted in some bizarre trends in the enforcement area. Breaches of what were once thought to be private, confidential relationships — such as those between husband and wife,[8/] parent and child, [9/]and doctor and patient[10/] — have been transmogrified into serious federal crimes thereby giving rise to a federal common law crime of

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8/ *See, e.g., United States v. Chestman*, 947 F.2d 551 (2d. Cir. 1991), *cert. denied*, 503 U.S. 1004 (1992); *Securities and Exchange Comm'n v. Lenfest*, 949 F. Supp. 341 (E.D. Pa. 1996).

9/ *See, e.g., Securities and Exchange Comm'n v. Sheinberg*, 1992 WL 372190 (S.E.C. Release No. 13465) (C.D. Cal. 1992); *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y.), *rev'd on other grounds*, 773 F.2d 477 (2d Cir. 1985).

10/ *See, e.g., United States v. Willis*, 737 F. Supp. 269 (S.D.N.Y. 1990); *Securities and Exchange Comm'n v. Cooper*, 1995 WL 739046 (S.E.C. Release No. 14754) (C.D. Cal. 1995).

"fraud" enforced by the Department of Justice and the S.E.C. Their inquiries into misconduct under the misappropriation theory turn on detailed examinations of these types of private relationships never before subjected to federal regulation. These proceedings illustrate the breadth of, and dangers inherent in, the Government's malleable "misappropriation theory."

Members of Congress have noted these dangers, and have called for a more definitive explanation of the misappropriation theory. For instance, Senator D'Amato, the ranking member of the Securities subcommittee in 1987, recognized that: "it is incumbent upon Congress to confront the basic policy questions of what uses of informational advantage are to be forbidden, rather than leaving the law to be developed on a case by case basis."[11/]

To date, Congress has failed to amend Section 10(b) to describe with more precision the circumstances under which trading while in possession of material nonpublic information is to be prohibited. In an illustrative episode, when Congress was considering the Insider Trading Sanctions Act of 1984, the Chairman of the S.E.C. and the Director of the S.E.C.'s Division of Enforcement acknowledged in their testimony that the current state of the law was so ambiguous that it did not "permit investors to chart their course of conduct confident in their obligations."[12/] Nevertheless, the S.E.C. *opposed* efforts to define insider trading in the 1984 Act, citing its preference for the "flexibility" offered by "case-by-case" determinations, which enabled the S.E.C. to prosecute "evolving types of conduct."[13/]

In 1987, some in Congress once again sought to address the

11/ *Definition of Insider Trading: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, Part I, 100th Cong. 4 (1987) (statement of Sen. D'Amato).

12/ *The Insider Trading Sanctions Act of 1983: Hearing on H.R. 559 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong. 35 (1984) (statement of John M. Fedders).

13/ *Id.* at 35, 37. *See also id.* at 38 ("there is no real benefit of clarity of [insider trading] law to investors and the Commission").

misappropriation theory by proposing legislation that would define the unlawful uses of misappropriated information. *See* S. 1380, 100th Cong. (1987). The sponsors' memorandum accompanying the proposed legislation, the "Insider Trading Proscriptions Act of 1987," noted that "the misappropriation theory . . . is itself a judicially-created construct, the parameters of which have never been addressed by either Congress or the Supreme Court."[14/] In connection with congressional hearings in 1987, the S.E.C. proposed enactment of a statute that would have expressly made it unlawful for any person to purchase or sell securities based on material nonpublic information that was "obtained wrongfully," which included information obtained by "conversion, misappropriation, or any other breach of a fiduciary duty, breach of any personal or other relationship of trust and confidence, or breach of any contractual or employment relationship."[15/] Congress chose not to enact this proposal as part of the Insider Trading and Securities Fraud Enforcement Act ("ITSFEA") it passed in 1988.

This history suggests, at most, a statutory ambiguity. Under those circumstances, the courts are not empowered to guess about what Congress meant. The applicable principle is clear: when the Court must choose between "two readings of what conduct Congress has made a crime, it is appropriate, before we choose the harsher alternative, to require that Congress should have spoken in language that is clear and definite." *Williams v. United States*, 458 U.S. 279, 290 (1982) (citation and internal quotations omitted). Any other outcome invites a dangerous intrusion by the Judiciary into Congress' exclusive province of making the laws.[16/]

14/ *See* Explanatory Memorandum accompanying introduction of S. 1380, the proposed "Insider Trading Proscriptions Act of 1987," introduced by Senators D'Amato and Riegel on June 17, 1987, at 2, *reprinted in* 133 CONG. REC. 16,391 (1987).

15/ *The Insider Trading Proscriptions Act of 1987: Hearing Before the Subcommittee on Securities of the Committee on Banking, Housing, and Urban Affairs*, 100th Cong. at 28-30 (1987).

16/ *See Dunn v. Commodity Futures Trading Comm'n*, 117 S. Ct. 913, 921 (1997).

The Government and its *amici* urge the Court to step in, lest it leave a purported "gap" in Section 10(b). *See* Gov't Petition for Cert. at 12. The argument is better addressed to the Congress, who created any such "gap" and has the responsibility of closing it.[17/] Policy arguments about the social utility of doing so are matters of legislative concern. As the Congress has recently shown, when the Court finds such a "gap" in Section 10(b), Congress can promptly fill it in the manner Congress decides is most appropriate.[18/]

II. THERE IS NO EVIDENCE THAT CONGRESS INTENDED THAT SECTION 10(b) CRIMINALIZE ALL TRADING ENABLED BY A BREACH OF TRUST OR CONFIDENCE.

Trading on the basis of misappropriated information was not unknown when Congress enacted the 1934 Act. On the contrary, Congress was aware of this phenomenon; the design of the 1934 Act reflects a carefully tailored response, one that does not encompass the misappropriation theory the Government now propounds before the Court, some sixty years later.

A. Congress Was Aware Of The Problem Of Trading On Misappropriated Information, And Chose Only To Prohibit Some Forms Of That Conduct

In 1934, Congress was well aware of the issues surrounding trading on the basis of misappropriated nonpublic information. The hearings that led up to the 1934 Act identified numerous instances "where insiders either personally or through the medium of holding companies participated largely in profits derived from

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17/ "The courts must declare the sense of the law; and if they should be disposed to exercise WILL instead of JUDGMENT, the consequence would equally be the substitution of their pleasure to that of the legislative body." THE FEDERALIST NO. 78, at 526 (Hamilton) (Jacob E. Cooke ed., 1961) (emphasis in original).

18/ In the aftermath of this Court's decision in the *Central Bank of Denver* case, Congress amended the 1934 Act to provide for aiding and abetting liability for Section 10(b) violations, but only in actions brought by the S.E.C.

the use of information not procurable by the investing public." S. Rep. No. 73-792, at 9 (1934). Congress considered these to be "[a]mong the most vicious practices unearthed at the hearings." S. Rep. No. 73-1455, at 55 (1934). They included numerous examples of "the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities." *Id.* The record leaves no room for doubt that insider trading was one of the principal examples of disruptive conduct that Congress sought to regulate through the 1934 Act.

Congress directly addressed some of the problems of trading on the basis of misappropriated corporate information in Section 16 of the 1934 Act. That section was designed to "protect the interests of the public against the predatory operations of directors, officers, and principal stockholders of corporations by preventing them from speculating in the stock of the corporations to which they hold a fiduciary duty." S. Rep. No. 73-1455, at 68.

Section 16 addresses this objective in three separate ways. Section 16(a) imposes public reporting obligations on corporate insiders and 10 percent shareholders, thereby requiring these insiders to disclose any changes in their ownership of the company's securities.[19/] Section 16(c) makes it unlawful for an insider to engage in "short" sales of the company's securities, or to sell "against the box" — transactions in which the insider bets against the performance of his own company.[20/]

19/ 15 U.S.C. § 78p(a). *See* H.R. Rep. No. 73-1383, at 13 (1934) ("the most potent weapon against the abuse of inside information is full and prompt publicity"); *Stock Exchange Regulation: Hearings on H.R. 7852 and H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong. 134 (1934) (testimony of Thomas G. Corcoran) ("We are simply saying to these men, 'If you are going to sell and get out, be honest about it. Say that you are getting out . . . but do not conceal the fact from your stockholders that you are selling out the company.'").

20/ 15 U.S.C. § 78p(c). In a "short" sale, the insider does not own the securities that he sells; the sale is effected by borrowing the security to make delivery to the purchaser, and subsequently buying an identical number of shares to deliver to the lender. Sales "against the box" are identical to "short" sales, except that the insider owns sufficient securities to cover the sale but nevertheless borrows the security to make delivery. Both

Section 16(b) is explicitly intended to deter trading on misappropriated information, both by insiders (officers and directors) and certain outsiders (10 percent shareholders). The section states that it was enacted "[f]or the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer." 15 U.S.C. § 78p(b). As enacted, Section 16(b) imposes strict liability for such transactions that occur during a six month period. The statute requires the insider to disgorge all profits realized on purchases and sales during this period "without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information." *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 595 (1973).

Because "the extensive legislative history of the 1934 Act is bereft of any explicit explanation of Congress' intent" concerning Section 10(b), *Hochfelder*, 425 U.S. at 201, there is no legislative history establishing that Congress intended in that section to impose criminal liability on outsiders who trade on misappropriated information. The conscious provision of non-criminal, prophylactic strict liability under Section 16(b) strongly indicates otherwise.[21/] Nor can any evidence of such intent be discerned in the language of the statute.[22/] Section 10(b)'s

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transactions have the same effect: the seller profits or avoids losses if the stock price declines between the time of the initial sale and the time of delivery to the lender. *See* Donald C. Cook & Myer Feldman, *Insider Trading Under the Securities Exchange Act*, 66 HARV. L. REV. 612, 637-38 (1953).

21/ The originally proposed version of Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b), made a violation into a criminal offense. Donald C. Cook & Myer Feldman, *Insider Trading Under the Securities Exchange Act*, 66 HARV. L. REV. 385, 407 (1953). A subsequent draft of that section eliminated potential criminal liability, because criminal liability for insider trading was seen as "too severe a penalty" for the conduct at issue. *Id. See also Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 248 n.23 (1976).

22/ Even if this were not true, the language of Rule 10b-5 was also not intended to cover misappropriation. Rule 10b-5 was a hastily-prepared administrative response to a single incident of perceived intentional conduct by a corporate insider without any consideration of misappropriation by outsiders. *See Conference on the Codification of the Securities Laws*, 22 BUS. LAW. 793, 922 (1967) (remarks of Milton V. Freeman, one

prohibition on "deceptive" devices employed "in connection with" a securities transaction does not readily lend itself to a prohibition on misappropriations of information in circumstances not involving deception of a party to the securities transaction.[23/]

The history of Section 10(b) reflects this reality. For years, Section 16 represented the entire scope of regulation of insider trading under the 1934 Act. Almost thirty years after Section 10(b)'s enactment, the S.E.C. determined that Section 10(b) and Rule 10b-5 barred trading by insiders or their affiliates on the basis of nonpublic corporate information because of the special duty owed by corporate insiders to shareholders. *See In the Matter of Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). The reasoning of *Cady, Roberts* is telling, for the S.E.C. justified the application of Section 10(b) and Rule 10b-5 based upon a disclosure duty flowing from the special relationship between the buyer and seller in the transactions at issue, which gave the shareholder the right to all material information known by the insider before making an investment decision. *See id.* at 911-13. If the misappropriation theory was believed to fall squarely within Section 10(b) when *Cady, Roberts* was decided, the duty of the insider to the shareholder would have been irrelevant and the ascension of the disclosure duty as the touchstone of insider trading law would never have occurred.

Thus, history shows that the Government's misappropriation theory arises not out of the language of the 1934 Act, or the legislative intent of Congress, or even the commonly understood scope of the statute in the years following its enactment. It arises instead out of what the Government considers a "gap" in what *should be* prohibited — a gap that flows from the very framework of Section 10(b) that the S.E.C. itself recognized in *Cady, Roberts*. That framework has been the foundation for this Court's jurisprudence regarding Section 10(b) for many years.

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of the Rule's co-drafters).

23/ *Cf. Dirks*, 463 U.S. at 656 (rejecting S.E.C. position that "anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading").

In its decisions applying Section 10(b)'s application to insider trading, this Court has drawn the line at classical insider trading — where an insider or his affiliate commits "deception" by trading with a person to whom he owes a fiduciary duty, without disclosing material information he knows. *See Chiarella*, 445 U.S. at 234-35; *Dirks*, 463 U.S. at 654. As in the S.E.C.'s first consideration of this issue in *Cady, Roberts*, these cases turn on the presence or absence of a duty to disclose flowing between the parties to the transaction. *See Chiarella*, 445 U.S. at 230 ("such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction"); *Dirks*, 463 U.S. at 657-58. As the briefs of the parties and lower court decisions discuss at length, the Court's reasoning in those cases will not encompass the much broader misappropriation theory, which imposes liability on outsiders who misappropriate information, and then use that information in transactions with people that have no reasonable expectation of disclosure and who are not named in the indictment among the injured parties.

B. Congress' Actions Since 1934 Have Not Altered The Scope Of Section 10(b)

The suggestion by the Government and its *amici* that, more than fifty years after passage of the 1934 Act, "Congress confirmed the validity of the misappropriation theory of liability, when it bolstered sanctions for insider trading" is both unavailing and untrue.[24/] Their entire argument rests on a remedial provision in legislation that expressly disavows any intent to alter the scope of Section 10(b), and inconclusive snippets from legislative debates. Ironically, the full record of Congress' consideration of the misappropriation theory since its creation in 1981 refutes the Government's argument, by demonstrating that Congress in fact *declined* to amend the 1934 Act to criminalize trading on misappropriated information, and that it did so at the S.E.C.'s urging.

24/ *See* Gov't Br. at 32-33; Brief for North Am. Sec. Adm'rs Ass'n and Law Professors as *Amici Curiae* at 16-27.

The Government's first argument is that Congress' amendment of the securities laws since the birth of the misappropriation theory in 1981 demonstrates tacit approval of that theory. Gov't Br. at 32-35. But this Court has routinely rejected that interpretive approach, holding that Congress' amendment of one provision in a statute does not mean that it has acquiesced in the courts' interpretation of another provision.[25/] A consistent judicial construction may be incorporated when Congress reenacts the statutory language at issue, but "Congress has not reenacted the language of § 10(b) since 1934, however, so we need not determine whether the other conditions for applying the reenactment doctrine are present." *Central Bank of Denver*, 511 U.S. at 185. Moreover, in the remedial provision cited by the Government, Congress specifically directed that it was not intending to alter the underlying criminal offense. *See* 15 U.S.C. § 78t-1(e) ("Provisions not to affect public prosecutions").

The government also argues that portions of the legislative debate over ITSFEA demonstrate Congress' agreement that Section 10(b) encompasses the misappropriation theory of liability. *See* Gov't Br. at 33-34 and n.18. That approach to statutory interpretation has also been rejected by the Courts. "[T]he interpretation given by one Congress (or a committee or Member thereof) to an earlier statute is of little assistance in discerning the meaning of that statute."[26/] Moreover, there are a number of more direct and contrary statements in the legislative

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25/ "Congress may legislate . . . only through passage of a bill which is approved by both Houses and signed by the President. . . . Congressional inaction cannot amend a duly enacted statute." *Central Bank of Denver*, 511 U.S. at 186 (*quoting Patterson v. McLean Credit Union*, 491 U.S. 164, 175, n.1 (1989)). *See also Rivers v. Roadway Express*, 511 U.S. 298, 313 (1994) ("Congress . . . has the power to amend a statute that it believes [has been] misconstrued [by the courts]. . . . No such change, however, has the force of law unless it is implemented through legislation."); *McNally v. United States*, 483 U.S. 350, 352-60 (1987); *Aaron*, 446 U.S. at 694 n.11 ("[T]he failure of Congress to overturn the Commission's interpretation falls far short of providing a basis to support a construction of § 10(b) so clearly at odds with its plain meaning and legislative history.").

26/ *Central Bank of Denver*, 511 U.S. at 185-86 (*quoting Public Employees Retirement Sys. v. Betts*, 492 U.S. 158, 168 (1989)); *see Weinberger v. Rossi*, 456 U.S. 25, 35 (1982); *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 118, and n.13 (1980).

record. For example, in passing ITSFEA, the House committee was careful to state that "the Committee does not intend to alter the substantive law with respect to insider trading with this legislation," H.R. Rep. No. 100-910, at 11 (1988).

In the end, the arguments of the Government and *amici* regarding congressional acceptance of the misappropriation theory emphasize the one thing that has never occurred. Congress has never passed, and the President has never signed, legislation that states that the conduct of Mr. O'Hagan in this case is unlawful and should be subject to criminal prosecution, as well as S.E.C. civil law enforcement prosecutions. Because *that* is what is required to designate activities criminal, the arguments of supposed congressional acquiescence in other forms fail.

CONCLUSION

Twice before, the Government has come to this Court with theories of misbehavior that it has attempted to shoehorn into the statutory language and history of Section 10(b). Twice, this Court has rebuffed those attempts. The misappropriation theory is the Government's most recent effort to expand the scope of Section 10(b). The theory is nothing if not a clever exercise in formal logic and linguistics. But one cannot lawfully be convicted of a federal crime for violating a plausible theory of what a statute may mean. Rather, the Courts must be able to discern, from the language chosen by Congress to describe its prohibition or from the circumstances of the law's enactment, an exercise of political will to criminalize the course of conduct encompassed by the theory. The misappropriation theory does not meet this standard.

For the foregoing reasons, we respectfully urge the Court to affirm the judgment of the court of appeals.

Respectfully submitted,

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